



## Low Earnings Confidence

So far 2019 has been lackluster for KSA healthcare sector (+1%) vs +9% for the TASI. Prior quarter results generally disappointed on thin topline growth and dramatic earnings contraction. While we expected growth slowdown, margin compression and stretched balance sheets have been acknowledged and absorbed by investors, there continues to remain a lack of confidence in earnings visibility. Our preferred names remain Care and Hammadi which can focus on optimizing existing assets while others contend with ramp-up costs associated with expansion.

### Substantial topline slowdown deeply compressed margin in prior quarter

1Q19 results suggest that the sector has not turned the corner despite revised pricing fully reflected and regular payments on receivables. Revenues for the group edged higher by only +1% as both Care (-13% Y/Y) and MEAHCO (-11% Y/Y) suffered from lower patient traffic. Meanwhile rising costs drove c. 1200 bps median gross margin contraction and group earnings declined by -30% Y/Y. One thought that comes to mind is how can this cost structure sustain if it is premised on double-digit topline growth? Particularly if pricing power is diminishing and patient figures are not rebounding.

### Some encouraging labor figures could limit slide

There are two possible means to recover patient numbers: inflow of foreign workers and access to private healthcare for public sector employees. 1Q19 labor figures, according to GA Stat, indicate that foreign workers increased by 224k – the first time in trailing 8 quarters – possibly as development kicks-off on major projects. Note that between 2016 and 2018, the number of foreign workers declined by nearly 1.5m. Second, public sector workers (c. 1.5m) could gain broad access to private healthcare if MoH shifts entirely to a regulatory role. In this scenario, pricing will be critical.

### Earnings to remain subdued as expenses outpace revenue growth

For 2Q19, we see modest improvement in revenue growth (+2% Y/Y) led by Mouwasat. We caution that revenues could shrink during the quarter, possibly on lower expat numbers Y/Y or discount pricing. Median gross margin for the group is expected to further moderate by 500 bps as costs continue to escalate, particularly for those providers bringing new capacity online (Dallah, MEAHCO, Mouwasat). Group earnings are expected to decline -7% Y/Y vs -30% Y/Y drop in the prior quarter (largely due to MEAHCO and Dallah).

### Valuation at slight premium to peer group

Our forecasts over the next 5 years reflect secular changes impacting KSA healthcare, however uncertainty remains, particularly if patient numbers fail to recover. We believe the sector trades at a slight premium to international peers (15x EV/EBITDA vs 13x and 27x P/E vs 26x) which is justified given superior, albeit diminishing, margins.

#### 2Q19 FORECAST

SAR mln	Revenues			Gross Margin		Operating Income			Net Income		
	2Q19E	2Q18	Y/Y Chg	2Q19E	2Q18	2Q19E	2Q18	Y/Y Chg	2Q19E	2Q18	Y/Y Chg
Mouwasat	452	408	11%	46%	49%	108	99	9%	101	95	6%
Dallah	283	273	4%	33%	34%	24	20	24%	18	19	(2%)
Care	175	199	(12%)	24%	25%	26	26	(1%)	22	20	6%
Hammadi	230	214	7%	26%	25%	32	31	2%	19	20	(3%)
MEAHCO	335	346	(3%)	29%	34%	15	32	(54%)	15	34	(56%)
Group	1,475	1,441	2%	29%	34%	204	207	(1%)	175	188	(7%)

Source: Company Reports, SFC

#### Rating Summary

SAR	Last Close	Rating	Target Price
Mouwasat   4002	88.70	Hold	85
Dallah   4004	50.70	Hold	63
Care   4005	56.30	Buy	56
Hammadi   4007	21.62	Buy	34
MEAHCO   4009	27.40	Sell	22

#### EPS (Attributable)

SAR	2Q19E	2Q18	Y/Y Chg
Mouwasat	0.94	0.88	7%
Dallah	0.24	0.25	(2%)
Care	0.48	0.45	6%
Hammadi	0.16	0.17	(3%)
MEAHCO	0.16	0.37	(56%)

#### Valuation

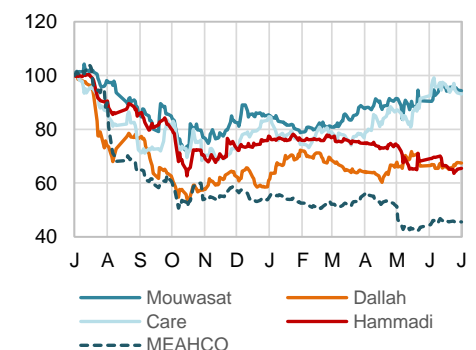
P / E	2018	2019E	2020E
Mouwasat	23.1x	24.2x	21.6x
Dallah	26.8x	36.7x	31.6x
Care	40.6x	29.1x	30.3x
Hammadi	28.9x	25.7x	22.6x
MEAHCO	14.6x	41.2x	44.1x

#### EBITDA Margins

	2018	2019E	2020E
Mouwasat	31%	27%	27%
Dallah	19%	18%	19%
Care	21%	25%	25%
Hammadi	25%	26%	25%
MEAHCO	18%	14%	14%

Source: SFC

#### 1-Year Share Performance (Rebased)



Source: Bloomberg

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### Rating Framework

#### **BUY**

Shares of company under coverage in this report are expected to outperform relative to the sector or the broader market.

#### **HOLD**

Shares of company under coverage in this report are expected to perform inline with the sector or the broader market.

#### **SELL**

Shares of company under coverage in this report are expected to underperform relative to the sector or the broader market.

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